

Internal Revenue Service  
Director, Exempt Organizations

Department of the Treasury  
P.O. Box 2508 - EP/EO  
Cincinnati, OH 45201

Date: JAN 12 2000 . .

Employer Identification Number:  
[REDACTED]

Person to Contact - I.D. Number:  
[REDACTED]

Contact Telephone Numbers:

telephone [REDACTED]

fax [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(7) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

Your organization has not established exemption from Federal income tax. Since you are a corporation it will be necessary for you to file an annual income tax return on Form 1120.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

1/12/00

If we do not hear from you within the time specified, this will become our final determination.

Sincerely,

Steven T. Miller

Director, Exempt Organizations

Enclosures: 3

Enclosure I

Facts:

[REDACTED], herein after referred to as the Association, was incorporated under the laws of [REDACTED].

The Certificate of Incorporation provides that the Association was formed for the following purposes:

- a. To promote and maintain sound management in the operation of social fraternities located at [REDACTED], [REDACTED]
- b. To employ appropriate staff who will act in an advisory capacity to such fraternities, particularly the house managers or stewards and the treasurers thereof.
- c. To establish procedures by which such fraternities may purchase commonly needed commodities, including, but not limited to, fuel, food, furniture and furnishings, equipment and supplies and commonly needed maintenance and housekeeping services in order to secure the benefits accruing from such cooperative action.
- d. To provide such other services to such fraternities as the Board of Directors of the corporation may approve and which benefits the fraternity system at [REDACTED].

The Bylaws provide that the Association exists for the efficient management of the fraternities and sororities at [REDACTED]. In order to fulfill this purpose, the Association's activities shall include but not be limited to cooperative action relating to purchasing, accounting, financial integrity, safety, building maintenance and educational services.

The membership of the Association consists of the following fraternity and sorority houses at [REDACTED]:

- a. [REDACTED]
- b. [REDACTED]
- c. [REDACTED]
- d. [REDACTED]
- e. [REDACTED]
- f. [REDACTED]
- g. [REDACTED]
- h. [REDACTED]
- i. [REDACTED]

Each member fraternity and sorority is to be represented by their respective [REDACTED], [REDACTED]t, [REDACTED], and [REDACTED].

The Attachment A regarding the Form 1024 Part II, Activities and Operational Information, states the Association offers the following management and asset maintenance services to member fraternity and sorority houses:

- a. Room and board billing in a cooperative arrangement with [REDACTED]
- b. Miscellaneous billings.
- c. Group rate insurance programs for fraternity and sorority houses and their employees.
- d. Group pricing for purchasing and vendor services.
- e. Monthly financial statements for the houses.
- f. Money market and high-yield mutual fund investment services.
- g. Accounts Payable processing.
- h. Payroll related services for fraternity and sorority house employees including direct paycheck deposit services; processing of employer payroll taxes; obtaining coverage for workers compensation insurance and disability insurance.
- i. Property management systems and services.
- j. Fund drive collection agent.
- k. Delinquent account collection services.
- l. Property management education and undergraduate officer training for members.

The Attachment A further states that the amount of time spent on each individual activity varies. Some activities (such as cash management) are performed daily for each member house. Other activities are performed on an as-needed basis. The nature of the services provided depends upon the level selected by the fraternity/sorority house.

Membership in the Association is open to recognized fraternities and sororities of [REDACTED]. There are two classes or categories of membership, full service and reduced service.

The "Full Service" membership provides the member fraternity/sorority a full range of services offered by the Association.

The "Reduced Service" membership provides the member fraternity/sorority only services agreed upon by both parties. These services are generally fewer in number than provided for "Full Service" membership.

Only "Full Service" members may hold positions on the Board of Directors.

Membership is voluntary for a fraternity/sorority house. However, once a house joins, it cannot resign until the end of the Association's fiscal year ([REDACTED]).

The Association employs [REDACTED] paid staff members, [REDACTED] of which are full time employees.

[REDACTED] of your financial support is derived from membership fees. Membership fees are determined by the level of service provided and are charged based upon the total account receivable billing of the member house. Full service member houses pay a [REDACTED] % fee and reduced

service member houses pay 8% to 8%. Any excess funds are reimbursed to the individual member houses for their own use.

Your expenses include the following; salaries and wages, occupancy, payroll taxes, audit and tax, equipment and furniture, maintenance and repairs, legal, travel, IFC support, employee benefits, telephone, postage, supplies, printing, insurance, consulting, credit card fees, and ADP fees.

#### Law:

Section 501(c)(7) of the Code provides for the exemption from Federal income tax of clubs organized for pleasure, recreation, and other non-profitable purposes (which has been defined by the courts as meaning other purposes similar to pleasure and recreation), substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

To qualify as a tax-exempt social club under Section 501(c)(7), an organization not only must be a non-profit entity but must also meet both an organizational test and an operational test. To satisfy the requirement of a pleasure, recreation, or other permissible purpose, the club must have an established membership of individuals, personal contacts, and fellowship and must show that its membership is bound together by a common objective that is directed towards pleasure, recreation, and other non-profitable purposes.

In Chattanooga Automobile Club v. Commissioner, Warren Automobile Club, Inc. v. Commissioner, 182 F. 2d 551 (6<sup>th</sup> Cir. 1950), the United States Court of Appeals 6<sup>th</sup> Circuit held that to be exempt under the Act of Congress, a club must have been organized and operated exclusively for pleasure, recreation, and other non-profitable purposes. The court further specified that the words "other non-profitable purposes" must be construed as coming within the same classification as pleasure and recreation. In addition, there must be at least some sort of commingling of members to constitute a club. The court held that the two automobile clubs petitioning the court were not exempt under section 101(9) of the Internal Revenue Code of 1939 as a social club because the members of these clubs did not commingle.

In Keystone Automobile Club v. Commissioner, 181 F. 2d 402 (3<sup>rd</sup> Cir. 1950), the United States Court of Appeals 3<sup>rd</sup> Circuit defined the word "club" to include some type of mingling of people together as well as a common object. In this case, the court held that the Keystone Automobile Club was not exempt under section 101(9) of the Code for a number of reasons one of which was because they saw no evidence of the commingling of members.

Revenue Ruling 55-716, 1955-2 CB 263 held that an organization formed to furnish television antenna service to its members upon payment of a stipulated membership fee and a monthly charge for maintenance of the antenna was not tax exempt under section 501(c)(7). The ruling states

that the term "club" contemplates a commingling of members and personal contacts and fellowship must play a material part in the life of an organization in order for it to come within the meaning of the term "club". Accordingly, the organization was denied exemption under section 501(c)(7).

Revenue Ruling 58-589, 1958-2 CB 266 sets forth the criteria or tests for determining whether an organization qualifies for exemption from Federal income tax under section 501(a) of the Internal Revenue Code of 1954 as an organization described in section 501(c)(7) of the Code. The ruling states that an organization must establish that it is a club both organized and operated exclusively for pleasure, recreation, and other non-profitable purposes and that no part of its net earnings inure to the benefit of any private shareholder or individual. To meet the first requirement, there must be an established membership of individuals, personal contacts, and fellowship. A commingling of the members must play a material part in the life of the organization. In addition, the ruling states that a club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, etc. may not be considered as being organized and operated exclusively for pleasure, recreation, or social purposes.

Revenue Ruling 66-360, 1966-2 CB 228 held that a national sorority and its member chapters which were founded by a business corporation as a non-profit organization for the purpose of forming chapters for the study and mutual pursuit of culture and friendly social contact does not qualify for exemption under section 501(c)(7). The sorority described in this ruling received all supplies and general management, clerical, and administrative services from the business corporation. In consideration for these services, the sorority turned over to the corporation all initiation and annual fees payable to it by the members of its chapters for the privilege of obtaining and continuing membership in the national sorority. The organization was not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes and was denied exemption under section 501(c)(7).

Revenue Ruling 67-428 1, 1967-2 CB 204 held that an organization formed for the purposes of governing and developing an amateur sport in the United States is not exempt under section 501(c)(7). The organization's membership are clubs devoted to the pursuit of the sport; it has no individual members. Delegates appointed by the member clubs meet periodically to conduct the affairs of the federation. Although fellowship need not be present between each member, it must constitute a material part of the organization's activities. The requirement of individual membership derives from the requirement of personal contacts and fellowship between members. It is evident that fellowship between members cannot play a material part in the activities of an organization composed of artificial entities. Accordingly, the organization was denied exemption under section 501(c)(7).

Revenue Ruling 69-527, 1969-2 CB 125 held that an organization formed to assist its members in their business endeavors through study and

discussion of problems and other activities at weekly luncheon meetings does not qualify for exemption under section 501(c)(7). To qualify for exemption under section 501(c)(7) an organization must be both organized and operated for pleasure, recreation, and other non-profitable purposes. Consequently, not only must an organization show that its members are bound together by a common objective, but that such common objective is directed towards pleasure, recreation, and other non-profitable purposes. The organization was organized and operated primarily to aid its members in their individual business endeavors and any social activities were merely incidental to the business activities of the organization. Accordingly, the organization was denied exemption under section 501(c)(7).

Revenue Ruling 69-635 1, 1969-2 CB 126 held that an automobile club whose principal activity is rendering automobile services to its members but has no significant social activities does not qualify for exemption under section 501(c)(7). The rendition of automobile services is not in the nature of pleasure and recreation within the meaning of section 501(c)(7). Furthermore, a commingling of members does not play a material part in the activities of the organization. Accordingly, the organization was denied exemption under section 501(c)(7).

#### Taxpayer's Position:

The Association contends they qualify for exemption under section 501(c)(7) of the Code because their activities are social in nature.

In a letter dated [REDACTED] the Association indicated the following:

- a. An alumni representative and the main undergraduate officers of each house ([REDACTED], [REDACTED], and [REDACTED]) represent each member house.
- b. Interaction between undergraduate officers of each member house and the Association's staff is constant and contact between different house officers is frequent.
- c. Membership classification by house is a function of determining the service fee assessed for operations performed by the Association.
- d. The Association facilitates the pursuit of social activities by freeing member house officers from operational activities.
- e. The Association is the sponsor for many of the member house's social activities such as dinners, white water rafting, parties, receptions, and picnics.
- f. The Association hosts a meeting of member house representatives at least twice a year.
- g. Any excess funds are reimbursed to the member houses for their own use.

In a letter dated [REDACTED] the Association re-emphasized the items detailed in the [REDACTED] letter and also indicated the following:

- a. The Association's services are not commercially available.

- b. The Association was designed as a cooperative arrangement among fraternities/sororities at [REDACTED] to provide assistance with certain common activities shared by them and have these services performed in a financially responsible manner.

Conclusion:

Based on the facts presented above, we hold that the Association does not meet the requirements for tax exemption under section 501(c)(7) of the Code. Personal contacts and fellowship does not play a material part in the activities of the Association. The Association is composed of artificial entities and their primary objective is to provide centralized management services for member houses. The centralized management services offered are designed to permit a cooperative approach in purchasing supplies and materials, insurance acquisition, billings, cash management, house maintenance, and housekeeping services, thereby enabling member houses to take advantage of group rates and bulk purchasing.

Like the organizations in court cases Chattanooga Automobile Club v. Commissioner, Warren Automobile Club, Inc. v. Commissioner and Keystone Automobile Club v. Commissioner and Revenue Rulings 58-716, 58-589, and 69-635 the activities of the Association does not include the commingling of members, which is a requirement of section 501(c)(7). The sponsoring of insubstantial social activities and mandatory meetings of member representatives does not constitute the commingling of members.

Furthermore, like the organization in Revenue Ruling 67-428, the Association is composed of artificial entities. Revenue Ruling 67-428 emphasizes that artificial entities are incapable of producing the personal contacts and fellowship contemplated by section 501(c)(7). Such Revenue Ruling clearly indicates that artificial entities, such as corporations, are not a type of "member" that is considered as falling within the term member for purposes of section 501(c)(7).

Since corporate members of a club are not the kind of members contemplated by the statute, a club in permitting such a type of membership is, in fact, dealing with the general public, in the form of the corporation's employees or officers.

Also, like the organizations in Revenue Rulings 66-360 and 69-527, the Association is organized and operated primarily to aid its members in their individual business activities and any social activities are merely incidental to their business purpose.

Accordingly, we conclude that the Association does not qualify for exemption under section 501(c)(7) of the Code.

Department of the Treasury - Internal Revenue Service  
Consent to Proposed Adverse Action  
(All references are to the Internal Revenue Code)

Case Number

Date of Latest Determination Letter

Employer Identification Number

Date of Proposed Adverse Action Letter

Name and Address of Organization

JAN 12 2000

I consent to the proposed adverse action relative to the above organization as shown below. I understand that if Section 7428, Declaratory Judgments Relating to Status and Classification of Organizations under Section 501(c)(3), etc. applies, I have the right to protest the proposed adverse action.

NATURE OF ADVERSE ACTION

☒ Denial of exemption

☐ Revocation of exemption, effective.

☐ Modification of exemption from section 501(c)( ) to section 501 ( ), effective

☐ Classification as a private foundation described in section 509(a)), effective

☐ Classification as an private operating foundation described in sections 509(a) and 4942(j)(3), effective for

☐ Classification as an organization described in section 509(a)( ), effective

☐ Classification as an organization described in section 170(b)(1)(A)( ), effective

If you agree to the adverse action shown above, please sign and return this consent. You should keep a copy for your records.

If you sign this consent before you have exhausted your administrative appeal rights, you may lose your rights to a declaratory judgement under section 7428.

(Signature Instructions on Back)

Name of Organization:

Signature and Title

Date

Signature and Title

Date